carryforwards. In 1996, Y's only transaction is the sale of Asset #1 for $5,000,000. Therefore, Y has net recognized built-in gain in 1996 of $1,000,000 ($5,000,000 − $4,000,000=$1,000,000) and a tentative tax under paragraph (a)(3) of §1.1374–1 of $350,000 ($1,000,000×.35=$350,000, assuming a 35 percent tax rate). Also, Y's tentative minimum tax determined under paragraph (b) of this section is $47,000 [$5,000,000 − $4,750,000=$250,000 − $15,000 ($40,000 corporate exemption amount −$25,000 phase-out = $15,000) = $235,000×.20 = $47,000, assuming a 20 percent tax rate]. Thus, Y may use its minimum tax credit in the amount of $303,000 ($350,000 − $47,000=$303,000) to offset its section 1374 tentative tax. As a result, Y's section 1374 tax is $47,000 ($350,000 − $303,000=$47,000) in 1996 and Y has a minimum tax credit attributable to years for which Y was a C corporation of $7,000 ($310,000 − $303,000=$7,000).

[T.D. 8579, 59 FR 66469, Dec. 27, 1994]

§ 1.1374–7 Inventory.

(a) *Valuation*. The fair market value of the inventory of an S corporation on the first day of the recognition period equals the amount that a willing buyer would pay a willing seller for the inventory in a purchase of all the S corporation's assets by a buyer that expects to continue to operate the S corporation's business. For purposes of the preceding sentence, the buyer and seller are presumed not to be under any compulsion to buy or sell and to have reasonable knowledge of all relevant facts.

(b) *Identity of dispositions*. The inventory method used by an S corporation for tax purposes must be used to identify whether the inventory it disposes of during the recognition period is inventory it held on the first day of that period. Thus, a corporation using the LIFO method does not dispose of inventory it held on the first day of the recognition period unless the carrying value of its inventory for a taxable year during that period is less than the carrying value of its inventory on the first day of the recognition period (determined using the LIFO method as described in section 472). However, if a corporation changes its method of accounting for inventory (for example, from the FIFO method to the LIFO method or from the LIFO method to the FIFO method) with a principal purpose of avoiding the tax imposed under section 1374, it must use its former method to identify its dispositions of inventory.

[T.D. 8579, 59 FR 66469, Dec. 27, 1994]

§ 1.1374–8 Section 1374(d)(8) transactions.

(a) *In general*. If any S corporation acquires any asset in a transaction in which the S corporation's basis in the asset is determined (in whole or in part) by reference to a C corporation's basis in the assets (or any other property) (a section 1374(d)(8) transaction), section 1374 applies to the net recognized built-in gain attributable to the assets acquired in any section 1374(d)(8) transaction.

(b) *Separate determination of tax*. For purposes of the tax imposed under section 1374(d)(8), a separate determination of tax is made with respect to the assets the S corporation acquires in one section 1374(d)(8) transaction from the assets the S corporation acquires in another section 1374(d)(8) transaction and from the assets the corporation held when it became an S corporation. Thus, an S corporation's section 1374 attributes when it became an S corporation may only be used to reduce the section 1374 tax imposed on dispositions of assets the S corporation held at that time. Similarly, an S corporation's section 1374 attributes acquired in a section 1374(d)(8) transaction may only be used to reduce a section 1374 tax imposed on dispositions of assets the S corporation acquired in the same transaction. If an S corporation makes QSub elections under section 1361(b)(3) for a tiered group of subsidiaries effective on the same day, see §1.1361–4(b)(2).

(c) *Taxable income limitation*. For purposes of paragraph (a) of this section, an S corporation's taxable income limitation under §1.1374–2(a)(2) for any taxable year is allocated between or among each of the S corporation's separate determinations of net recognized built-in gain for that year (determined without regard to the taxable income limitation) based on the ratio of each of those determinations to the sum of all of those determinations.

(d) *Examples*. The rules of this section are illustrated by the following examples.